COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF SOUTH KENTUCKY RURAL ELECTRIC COOPERATIVE CORPORATION, INC. FOR AN ADJUSTMENT TO ITS RETAIL ELECTRIC POWER TARIFFS	))))	CASE NO. 94-400

O R D E R

On December 2, 1994, South Kentucky Rural Electric Cooperative Corporation, Inc. ("South Kentucky") filed an application to reduce its rates for retail electric service by $2,718,636 annually effective January 1, 1995. The proposed rate reduction was designed to pass on to South Kentucky's customers a decrease in power costs proposed by South Kentucky's wholesale power supplier, East Kentucky Power Cooperative, Inc. ("East Kentucky").[1] The decrease in power costs proposed by East Kentucky became effective January 1, 1995, subject to further modification, and South Kentucky's proposed rates became effective simultaneously under the same condition.

Intervening in this matter was the Attorney General of the Commonwealth of Kentucky, by and through his Public Service Litigation Branch ("AG"). A public hearing was held April 27, 1995 at the Commission's offices in Frankfort, Kentucky.

---

[1] Case No. 94-336, The Application of East Kentucky Power Cooperative, Inc. for an Adjustment to Its Wholesale Power Tariffs.

On July 25, 1995, the Commission approved a rate decrease for East Kentucky which was greater than it had proposed. Consequently, South Kentucky's power costs will decrease by an additional $598,597 annually for a total decrease of $3,317,233 annually. The manner in which this total decrease is passed on to South Kentucky's customers through reduced rates is discussed below.

ALLOCATION AND RATE DESIGN ISSUES

South Kentucky proposed to reduce its rates to reflect the full amount of East Kentucky's wholesale rate reduction. South Kentucky utilized an "equal reduction per Kwh" methodology which provides retail customers the same reduction per Kwh for all energy charges. This approach results in a straight pass-through of the East Kentucky decrease with no change to South Kentucky's existing rate design and no impact on its financial condition. South Kentucky was one of fourteen customers of East Kentucky utilizing this methodology while three others utilized the "equal percentage of revenue" methodology.

The AG recommends that the decrease be allocated on an equal percentage of revenue approach. The AG contends that this is the most equitable approach and its use here, in the absence of a cost-of-service study, is analogous to its use by the Commission in general rate cases when no cost-of-service studies are acceptable for revenue allocation purposes.

The AG also recommends that South Kentucky's declining block rates now be converted to flat rates. The AG argues that implementing a rate decrease is the ideal time to make such a change because any resulting harm will be less than if implemented with a rate increase. The AG argues that the Commission has made such changes without the benefit of cost-of-service studies in previous cases and that now is the time to eliminate declining block rate structures which encourage inefficient and wasteful use of electricity. The AG also questioned the continuation of the Electric Thermal Storage ("ETS") program and urged, if the program is continued, that retail ETS rates not be set below East Kentucky's wholesale off-peak energy rates. Noting that some South Kentucky rate schedules contained demand charges that were less than East Kentucky's proposed wholesale demand charges, the AG recommended that all retail demand charges be at or above the wholesale demand charges.

In rebuttal, South Kentucky contended that both revenue allocation methodologies are reasonable and that one should not be favored over the other. It maintained that the AG's proposed rate design changes should not be done within a pass-through proceeding, nor should they be done without the benefit of a cost-of-service study. South Kentucky was concerned that such changes would result in some customers receiving rate increases even though South Kentucky had filed for a rate decrease. It also expressed concern about the potential impact on its revenues if customers reduce consumption due to changes in rate design. South Kentucky supported East Kentucky's ETS program and urged that the existing ETS rate structure be maintained. South Kentucky indicated that, through the combination of its retail demand and energy charges, it was adequately recovering wholesale demand charges. It also noted differences in measuring demand at the wholesale and retail levels, i.e. coincident versus non-coincident peak, and that many of East Kentucky's cooperatives have historically priced retail demand charges below the corresponding wholesale demand charge.

Based on the evidence of record and being otherwise sufficiently advised, the Commission will approve the "equal reduction per Kwh" approach for allocating the decrease to retail rate classes for the following reasons. (1) The wholesale rate decrease from East Kentucky consists of decreased energy charges (per Kwh); therefore, an equal reduction per Kwh is a reasonable approach for the retail pass-through of the wholesale power cost decrease. (2) When a change in retail rates is caused by a change in only <u>one</u> expense item, purchased power, it is neither necessary nor appropriate to use a "percentage of revenue" allocation methodology. The Commission has at times utilized such a methodology where revenues are adjusted to reflect changes in multiple expenses. Here, however, revenues are being changed to reflect only one expense, purchased power. Under these circumstances, it is logical and reasonable that a change in cost be identified and reflected in the resulting change in retail rates.

The Commission finds merit in the AG's recommendation to implement changes in rate design. While a cost-of-service study may be essential properly to redesign certain categories of rates, it is not a prerequisite to eliminating declining block electric rates. Declining block rates send an inappropriate price signal to consumers, one that tends to promote the use of electricity in a manner that does not always result in an efficient use of resources. While there may be some justification for seasonal, off-peak use of declining block rates, the Commission generally favors flattening rates for energy consumption.

Declining block rates should be converted to flat rates to the greatest extent possible without undue disruption to South Kentucky or its customers. However, recognizing the concerns that such changes might result in rate increases for some customers and lower revenues to the utility due to reduced consumption, rates will be flattened to the extent possible without increasing any rate above the level in effect prior to this case. This will ensure that no customers experience a rate increase as a result of this case. Due to South Kentucky's existing rate design and the magnitude of its wholesale power cost decrease, this approach will result in all declining block rate schedules being converted to flat rates.[2]

The ETS rate issue is essentially moot due to the Commission's decision in East Kentucky's rate case to set the wholesale off-peak energy rates well below the retail ETS rate. The Commission, therefore, will approve the continuation of the existing ETS rate structure. Finally, on the issue of pricing retail and wholesale demand charges, the Commission recognizes that retail demand should

---

[2] This does not apply to customers served under special contracts.

not be priced below its wholesale cost. However, due to differences in measuring retail and wholesale demand, i.e. non-coincident versus coincident peak demands, below cost pricing cannot be presumed. There is no evidence to demonstrate that South Kentucky is not fully recovering its demand cost in retail demand rates. In addition, several of East Kentucky's distribution cooperatives indicated that they would be performing cost-of-service studies in the relatively near future. South Kentucky's next cost-of-service study should address the issue of retail recovery of wholesale demand cost.

IT IS THEREFORE ORDERED that:

1. The rates in Appendix A, attached hereto and incorporated herein, are approved for service rendered on and after the date of this Order.

2. Within 20 days of the date of this Order, South Kentucky shall file with the Commission revised tariff sheets setting out the rates approved herein.

Done at Frankfort, Kentucky, this 26th day of July, 1995.

PUBLIC SERVICE COMMISSION

Chairman

Robert M. Davis
Vice Chairman

Linda K. Breathitt
Commissioner

ATTEST:

Don Mills
Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 94-400 DATED July 26, 1995.

The following rates and charges are prescribed for the customers in the area served by South Kentucky Rural Electric Cooperative Corporation. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of this Commission prior to the effective date of this Order.

SCHEDULE A
RESIDENTIAL, FARM AND NON-FARM SERVICE

Rate:

Energy Charge
All KWH Per Month $.05363 Per KWH

MARKETING RATE - ETS

Rate:

All KWH $.03218 Per KWH

SCHEDULE B
SMALL COMMERCIAL RATE

Rate:

Energy Charge
All KWH Per Month $.05910 Per KWH

MARKETING RATE - ETS

Rate:

All KWH $.03546 Per KWH

SCHEDULE LP
LARGE POWER RATE

Rate:

Energy Charge	
All KWH Per Month	$.03408 Per KWH

SCHEDULE LP (CONTRACT 11)

Energy Charge	
First 3,500 KWH Per Month	$.03755 Per KWH
Next 6,500 KWH Per Month	.03649 Per KWH
Next 140,000 KWH Per Month	.03541 Per KWH
Next 150,000 KWH Per Month	.03488 Per KWH
Next 300,000 KWH Per Month	.03434 Per KWH

SCHEDULE LP (CONTRACT 14)

Energy Charge	
First 3,500 KWH Per Month	$.03825 Per KWH
Next 6,500 KWH Per Month	.03655 Per KWH
Next 140,000 KWH Per Month	.03328 Per KWH
Next 150,000 KWH Per Month	.03315 Per KWH
Next 300,000 KWH Per Month	.03305 Per KWH

SCHEDULE LP 1
LARGE POWER RATE
(1,000 KW to 4,999 KW)

Rate:

Consumer Charge	$125.00
Energy Charge	.02952 Per KWH

SCHEDULE LP 2
LARGE POWER RATE
(5,000 KW to 9,999 KW)

Rate:

Consumer Charge	$125.00
Energy Charge	
Per KWH for the first 425 KWH per KW of Billing Demand	.02952 Per KWH
Per KWH for all remaining KWH	.02351 Per KWH

SCHEDULE LP 3
LARGE POWER RATE
(1,000 KW to 2,999 KW)

Rate:

Consumer Charge	$1,069.00
Energy Charge	.02473 Per KWH

SCHEDULE OPS
OPTIONAL POWER SERVICE

Rate:

Energy Charge	
All KWH Per Month	$ .06567 Per KWH

SCHEDULE STL
STREET LIGHTING SERVICE

Rate Per Light Per Month:

Mercury Vapor or Sodium 7,000 - 10,000 Lumens	$	3.68
Mercury Vapor or Sodium 15,000 - 28,000 Lumens		5.68

SCHEDULE OL
OUTDOOR LIGHTING SERVICE
SECURITY LIGHTS

Rate Per Light Per Month:

Mercury Vapor or Sodium		
7,000 - 10,000 Lumens		
Unmetered	$	5.48
Directional Floodlight, Unmetered		8.58

SCHEDULE TVB
UNMETERED COMMERCIAL SERVICE

Class and Rates Per Month:

Cable TV Amplifiers (75 KWH Per Month)	$	7.07 Per Month